DEPARTMENT OF CONSUMER
& INDUSTRY SERVICES

OFFICE OF FINANCIAL AND INSURANCE SERVICES

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September 11, 2001

Frank M. Fitzgerald
Commissioner of Financial and Insurance Services

REPORT OF EXAMINATION OF

BCN
OF MICHIGAN
Detroit, Michigan

As of September 30, 2000

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In accordance with Section 222 of the Michigan Insurance Code, the Office of Financial and Insurance Services produced 300 copies of this report at a total cost of $284.28 or approximately $.95 each. This cost is funded by assessment fees charged to the insurance companies.

Honorable Frank M. Fitzgerald
Commissioner of Financial and Insurance Services
State of Michigan
Lansing, Michigan

Commissioner:

In accordance with instructions and pursuant to statutory requirements, we have examined the financial condition, management and operations of:

BCN of Michigan
25925 Telegraph Road
Southfield, Michigan

a nonprofit health maintenance organization hereinafter referred to as the "Company." Our examination report follows.

SCOPE OF EXAMINATION

The Office of Financial and Insurance Services (OFIS) conducted an examination of the Company for the period from January 1, 1998 to September 30, 2000. We conducted the examination in accordance with guidelines and procedures recommended by the Financial Condition (E) Committee of the National Association of Insurance Commissioners (NAIC) and the laws, rules and regulations prescribed by OFIS.

We reviewed and incorporated certain workpapers of the Company's independent auditors, Deloitte & Touche LLP, into our examination workpapers where appropriate.

To determine the adequacy of the claim reserves and related actuarial items, we hired the actuarial consulting firm of PricewaterhouseCoopers, LLP. The analysis was performed by Martin Staehlin, FSA, MAAA. The analysis consisted of the tests necessary to certify the adequacy of the claim reserves and related actuarial items. The actuarial certification of PricewaterhouseCoopers, LLP is attached to the report of examination as Exhibit 1. The actuary's detailed report is on file at our offices. We have tested the underlying data provided to the actuary for completeness and accuracy.

We verified and determined the Company's assets and liabilities as of September 30, 2000. We performed a limited review of the intervening years between the last examination and this September 30, 2000 examination. This review consisted mainly of an analytical review of the changes in the balance sheet and a review of the minutes of the board of directors and annual meetings of the stockholders, or anywhere we deemed it necessary. We also performed a limited market conduct review.

We also reviewed the following matters which have an impact on the Company's financial condition or conformity with related laws:

Conflict of Interest
Fidelity Bond and Other Insurance
Affiliated Agreements
Accounts and Records
Grievances

In addition, we reviewed transactions occurring subsequent to September 30, 2000 where deemed appropriate. Comment on the findings of our examination is limited to matters involving a departure from laws, rules or regulations; a significant change in the amount of an item; or where an explanation, comment or recommendation is deemed warranted. Any other adjustments or comments were discussed with Company personnel and may appear in a letter to management which was prepared in conjunction with this report of examination.

HISTORY AND PURPOSE

The Company is a federally qualified, nonprofit corporation formed in part "…to develop, plan, maintain, be licensed as, and operate a health maintenance organization…with all the power conferred upon health maintenance organizations by the laws of the State of Michigan."

The Company was incorporated on May 6, 1981, as a nonprofit corporation pursuant to the provisions of Act 327, Public Acts of 1931, as amended, Act 284 Public Acts of 1972, as amended and Act 264 of the Public Acts of 1974. The Company is a wholly owned subsidiary of Blue Cross and Blue Shield of Michigan (BCBSM).

During 1997, the four regional Blue Care Network (BCN) HMO's, all of which were wholly owned subsidiaries of BCBSM, began planning for consolidation into one corporation and functional statewide structure. BCN of Mid Michigan, BCN of East Michigan and BCN – Great Lakes were merged into BCN of Southeast Michigan which was renamed BCN of Michigan. The merger was effective February 1, 1998 pursuant to Act 162 of the Public Acts of 1982.

On June 29, 2000, Chapter 35 of the Michigan Insurance Code was enacted into law. Chapter 35 of the Michigan Insurance Code is comprehensive new legislation setting forth statutory requirements related to the business affairs of health maintenance organizations. With the passage of Chapter 35, health maintenance organizations are now subject to certain provisions of the Michigan Insurance Code. Before Chapter 35 was enacted into law, the Company was governed under Sections 21001 to 21098 of the Michigan HMO Act. Concurrent with the passage of Chapter 35, Sections 21001 to 21098 of the Michigan HMO Act were repealed.

MANAGEMENT AND CONTROL

Shareholders

The Company has authorized capital of 500 shares of $100 par value common stock issued and outstanding. All share are held by BCBSM. The organizational chart is attached as Exhibit 2.

Board of Directors

The bylaws of the Company state the board will consist of six or more directors. One-third of the directors are to be selected by the voting subscribers. Each subscriber is entitled to one vote for the purpose of electing enrollee directors. The remaining directors of the Company are appointed by BCBSM.

Each director holds office for a term of three years and until his or her successor is duly appointed and qualified. The initial terms are staggered so the terms of one-third of the directors expire each year.

Members of the board of directors as of September 30, 2000 are as follows:

Name	Affiliation
George Andros	Director UAW Region 1-D
Julie Angott	Ross Learning, Inc., LTC Director
Charles Burkett	Retired
Joseph DeFrain**	Apprentice Chairman UAW Local 659
Frank Garrison	President Emeritus, MI. State AFL-CIO
Anne Mare Ice, M.D.	Physician Provider for the Company
Gloria Klinge**	Human Resources Supervisor, Lear Corporation
Hon. Paula J. Manderfield**	54-A District Court Judge, Lansing, MI.
Robert H. Naftlay	Exec.V.P., BCBSM and President & C.E.O., PPOM
Carmone Owens**	Madison Heights Fire Department

David B. Siegel, M.D.	Senior V.P., Managed Care Division, BCBSM and President and C.E.O. of the Company
Gregory A. Sudderth	President, Construction Industry Resources, Inc.
Diana L. Watson**	President, Premier Healthcare Recruiters, Inc.
Roy Westran	Retired
Richard E. Whitmer	President and CEO, BCBSM

**Adult enrollee representative

Committees

In accordance with the Company's bylaws, an executive committee is serving as of September 30, 2000. The Company's bylaws provide for the Company's board to establish one or more additional committees, as needed. The Company also has audit, oversight, finance and healthcare quality service improvement committees as of September 30, 2000.

Officers

The Company's bylaws provide that the officers consist of a chairperson, vice-chairperson, second vice-chairperson, chief medical director, secretary, assistant secretary, treasurer, assistant treasurer, chief operating officer, chief executive officer and president. Two or more offices may be held by the same individual, except those of chairperson, vice-chairperson and president.

The officers serving as of September 30, 2000 are as follows:

Title	Name
Chairperson	Frank Garrison
Vice-Chairperson	Gregory A. Sudderth
President and CEO	David B. Siegel, M.D.
Secretary	Julie Swantek
CFO and Treasurer	Susan A. Kluge
Chief Medical Director	Douglas R. Woll, M.D.
Chief Operating Officer	Jeffrey W. Blancett
Assistant Secretary	Julie Swantek

TERRITORY AND PLAN OF OPERATION

The Company operates as a combination staff and network model health maintenance organization. The Company providers consist of physicians, medical centers and major hospitals located throughout the lower peninsula of Michigan.

The Company serves members in 64 Michigan counties. The Company's marketing program is administered by BCBSM under the terms of a management agreement. A manager of sales is responsible for supervising the BCBSM salaried sales representatives and independent agent/agencies.

The Company's enrollment as of September 30, 2000 was 603,148 members. Group, Medicare, Individual and Other members comprise 94.5, 3, 0.5 and 2 percent, respectively, of the enrollment.

GROWTH OF THE COMPANY

Year	Assets	Liabilities	Net Worth	Enrollment
1997*	$440,160,197	$260,722,122	$179,438,075	606,010
1998	427,525,598	329,373,471	98,152,127	594,456
1999	428,898,028	336,610,480	92,287,548	610,305
9/30/00*	395,756,579	321,042,992	74,713,587	603,148

*Per Report of Examination

STATE RESERVE

As a requirement of Chapter 35 of the Michigan Insurance Code, the Company is required to maintain a minimum deposit equal to $100,000 plus five percent of the Company's annual subscription income up to a maximum of $1,000,000. This deposit is kept in a segregated bank account to ensure the Company can provide medical services for which it has contracted, in the event of insolvency. These funds can only be used at the direction of the Commissioner of Financial and Insurance Services. Interest on these funds can be used by the Company. The Company's balance in this segregated account was $2,500,000 as of September 30, 2000.

STOP LOSS SELF INSURANCE

The Company has an agreement with a self-funded trust, Blue Care Network Stop Loss Self Insurance Trust (Stop Loss Trust), to cover inpatient claims in excess of a $150,000 deductible. The maximum payable per enrollee per lifetime for eligible services is limited only by the amount of funds in the Stop Loss Trust.

MALPRACTICE SELF INSURANCE

The Company has an agreement with a self funded trust, Blue Care Network Medical Malpractice Self Insurance Trust, to cover medical malpractice risk incurred up to a limit of $1 million per occurrence and $5 million aggregate. There is no deductible.

BLUE CARE NETWORK OF MICHIGAN
BALANCE SHEET
As of September 30, 2000

ASSETS	
Current Assets:	
Cash	$ (8,795,908)
Short-term Investments	183,216,273
Premiums Receivable	24,304,236
Investment Income Receivables	4,178,546
Health Care Receivable	2,194,503
Amounts Due from Affiliates	33,144,515
Securities Lending Collateral	24,875,439
Contractual Settlement Receivable	7,669,330
Inventories	1,261,047
Other Current Assets	1,100,778
Total Current Assets	$273,148,759
Other Assets:	
Bonds	$ 70,306,998
Common Stock	436,369
Other Long-Term Invested Assets	37,402,454
Amounts Due from Affiliates	2,123,244
Restricted Cash and Other Assets	2,500,000
Other Non-Current Assets	60,812
Total Other Assets	$112,829,877
Property and Equipment:	
Land, Building and Improvements	$ 490,356
Furniture and Equipment	2,666,319
Leasehold Improvements	966,016
Electronic Data Processing Equipment	5,655,252
Total Property and Equipment	$ 9,777,943
Total Assets	$395,756,579

BLUE CARE NETWORK OF MICHIGAN
BALANCE SHEET
As of September 30, 2000

LIABILITIES	
Current Liabilities:	
Accounts Payable	$ 7,799,948
Claims Payable	176,358,852
Accrued Medical Incentive Pool	7,754,553
Unearned Premiums	20,092,241
Amounts Due to Affiliates	25,606,891
Securities Lending Collateral	24,875,439
Accrued Salaries and Taxes	8,176,242
Physician Incentive-POS	6,430,393
Accrued Claims Processing Liabilities	2,352,044
Other Current Liabilities	3,302,314
Total Current Liabilities	$282,748,917
Other Liabilities:	
Postretirement Benefits Other Than Pensions	$ 30,594,863
Accrued Pension	7,589,994
Supplemental Pension Plan Liability	109,218
Total Other Liabilities	$ 38,294,075
Total Liabilities	$321,042,992
NET WORTH	
Common Stock	$ 50,000
Paid In Surplus	11,800,000
Contributed Capital	3,803,045
Equity In Affiliates	37,402,454
Retained Earnings	21,658,088
Total Net Worth	$ 74,713,587
Total Liabilities and Net Worth	$395,756,579

BLUE CARE NETWORK OF MICHIGAN
STATEMENT OF REVENUE, EXPENSES AND NET WORTH
For the Period Ending September 30, 2000

REVENUES	
Premium	$899,631,160
Fee-For-Service	4,778,151
Net Investment Income	13,320,194
Management Revenue	2,293,347
Pharmacy Revenue	53,530
Rent	137,264
Miscellaneous Revenue	62,932
Total Revenues	$920,276,578
EXPENSES	
Medical and Hospital:	
Physician Services	$178,421,106
Other Professional Services	244,670,733
Outside Referral	24,154,889
Emergency Room and Out-of-Area	30,523,294
Inpatient	181,002,845
Incentive Pool and Withhold Adjustments	5,053,986
Occupancy, Depreciation and Amortization	195,290
Pharmacy	152,952,600
Vision	665,534
Medical Malpractice Insurance	(128,660)
Dental	383,503
Other Medical	32,360,080
Subtotal	$850,255,200
Less:	
Net Reinsurance Recoveries Incurred	1,171,457
Co-Payments	1,428,287
Total Medical and Hospital	$847,655,456
Administration Expenses	$ 86,093,911
Total Expenses	$933,749,367
Net Income (Loss)	$ (13,472,789)
NET WORTH	
Net Worth at January 1, 2000	$ 92,287,548
Net Income (Loss)	(13,472,789)
Examination Adjustments	(8,601,977)
Change in Non-Admitted Assets	336,867
Unrealized Capital Gains and Losses	1,800,927
Change in Equity in Affiliates	2,363,011

Net Worth at September 30, 2000	$ 74,713,587

BLUE CARE NETWORK OF MICHIGAN
STATEMENT OF CASH FLOWS
For Period Ending September 30, 2000

CASH FLOWS FROM OPERATING ACTIVITIES

Net Income	$ (13,472,789)
Depreciation and Amortization	3,891,788
(Increase) Decrease in Operating Assets:	
Premium Receivable	3,819,245
Due from Affiliates	(6,199,956)
Health Care Receivables	(137,693)
Inventory	215,764
Interest Receivable	(467,068)
Non-Admitted Assets	336,867
Other Current Assets	836,961
Increase (Decrease) in Operating Liabilities:	
Medical Claims Payable	(18,961,687)
Due to Affiliates	(6,278,714)
Unearned Premiums	(42,137)
Accounts Payable	(784,808)
Accrued Medical Incentive Pool	2,934,566
Accrued Salaries and Taxes	1,111,478
Accrued Pension	696,656
Postretirement Benefits Other Than Pension	2,696,423
Supplemental Pension Liability	(5,068)
Other Accrued Liabilities	863,906
Net Cash Provided By Operating Activities	$ (28,946,266)
CASH FLOW FROM INVESTING ACTIVITIES	
Receipts from Investments	$4,817,871,167
Payments for Investments	(4,786,835,468)
Payments for Property, Plant, and Equipment	(832,485)
Other Non-Current Assets	16,090
Net Cash Used In Investing Activities	$ 30,219,304
Net Increase (Decrease) in Cash and Cash Equivalents	$ 1,273,038
Cash and Cash Equivalents at January 1, 2000	(10,068,946)
Cash and Cash Equivalents at September 30, 2000	$ (8,795,908)

BLUE CARE NETWORK OF MICHIGAN
EXAMINATION ADJUSTMENTS
As of September 30, 2000

Net Worth as of September 30, 2000, Per Company $ 83,315,564

	Balance Per Company	Balance Per Examination	Increase or Decrease ( ) in Net Worth
ASSETS:			
Premiums Receivable	$28,867,213	$24,304,236	$ (4,562,977)
LIABILITIES:			
Claims Payable	172,319,852	176,358,852	(4,039,000)
Total Examination Adjustments			$ (8,601,977)

Net Worth as of September 30, 2000, Per Examination $ 74,713,587

NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Corporate and Income Tax Status

The Company is a nonprofit stock corporation and a wholly owned subsidiary of BCBSM. The Company has been recognized by the Internal Revenue Service as an organization described under Internal Revenue Code Section 501(c)(4) as an organization exempt from tax under Section 501(a).

Revenue

Revenue from subscribers is recognized ratably over the period of coverage: premiums received in advance are recorded as unearned premium revenue. Other revenues consist primarily of fee-for-service revenue which is recognized as services are performed.

Cash Equivalents

Cash equivalents are carried at cost, which approximate fair market value, and are comprised of short-term investments with initial maturities at date of acquisition of 90 days or less.

Investments

The Company has classified its debt securities as available-for-sale: accordingly, its debt securities are carried at fair value. The Company has received a permitted practice from OFIS to report its investments at fair value for the year 2000. The unrealized gains and losses related to these securities are excluded from earnings and reported as a separate component of stockholder's equity as other comprehensive income. Realized gains and losses and declines in value judged to be other-than-temporary are reflected in investment income. The specific identification method is utilized to determine realized gains and losses.

Inventories

Inventories consist of pharmacy and medical supplies and are stated at cost, on a first-in, first-out basis.

Property and Equipment

Property and Equipment are stated at cost. Depreciation is recorded by the straight-line method over the estimated useful lives of the assets.

Unpaid and Unreported Claims

The liability for incurred but unpaid and unbilled medical and hospital claims is accrued in the period during which the services are provided, and includes actuarial estimates of services performed which have not been reported by providers to the Company. Such estimates are based on historical claims experience modified for current trends and changes in benefits provided. Revisions in actuarial estimates are reported in the period in which they arise. The Company has reinsured certain of its claims liabilities through an affiliated self-insured trust.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

2. CASH EQUIVALENTS AND INVESTMENTS

Cash equivalents include amounts invested in a pooled investment fund (Fund) managed by BCBSM. Cash equivalents invested in the Fund consist of corporate notes, commercial paper and money market funds.

Investments in the Fund consist of U.S. Government and agency securities, asset backed securities and collateralized mortgage obligations, corporate notes, commercial paper, and municipal bonds.

The Company in the normal course of business enters into investment transactions with BCBSM.

The Company determines its cost basis in the Fund based on the actual cost of the Fund units acquired. The Fund unit cost is determined by the market value of the Fund assets at the date of purchase, plus an administrative fee. The Fund units are marketable and the Company can convert its investment in the Fund to cash at current market prices. The Fund uses the specific identification method in computing realized gains and losses on sales of investments.

The Company in the normal course of business enters into securities lending agreements with various other counter parties. Under these agreements, the Company lends U.S. Treasury securities in exchange for collateral consisting of government sponsored agency securities and a nominal fee. These agreements are primarily overnight in nature and settle the next business day.

Pursuant to a plan filed with OFIS, the Company transferred balances belonging to other participants from the Fund during 4th quarter 2000 in order to comply with Section 3548(3).

3. RELATED PARTY TRANSACTIONS

Claims Processing

BCBSM processes certain hospital, hearing, and professional claims on behalf of the Company. The Company then reimburses BCBSM at agreed upon rates for claims and pays an administrative fee for each claim processed.

Administrative Cost Allocation

BCBSM provides the Company with miscellaneous administrative support, including computer operations support, and the Company is billed accordingly.

Insurance

The Company has an agreement with self-funded trusts to provide malpractice, reinsurance and reduced deductibles for property, general liability, automobile and fidelity insurance coverages. The trusts cover risks incurred in excess of a retention amount.

Health Insurance

The Company purchases health insurance benefits for certain of its employees from BCBSM. Additionally, BCBSM purchases health insurance for certain of its employees from the Company.

Capitated Health Care Programs

The Company participates in two capitated health care programs, sponsored by an affiliated company. The Company's participation in the two capitated health care programs is summarized below:

- Under the "Personal Plus" program, the Company receives monthly capitation from an affiliate for subscribers in the Company coverage area. The Company is responsible for collecting premiums and is at risk for all medical claims.

- Under the "Self-Referral Option" program, an employer can coordinate an out of area benefit for employees through an affiliate. The Company is responsible for collecting premiums and is not at risk for medical losses. Gains are divided at 50 percent with the affiliate.

Point of Service/Blue Preferred Plus/Community Health Initiative (CHI)

The Company provides BCBSM with miscellaneous administrative support for these BCBSM offered products. BCBSM bears all risk associated with these products as well as the CHI project.

Blue Care, Inc. (BCI)

The Company provides BCI and affiliated trusts with miscellaneous administrative support.

Contractual Relationship

BCBSM has entered into a series of agreements with Borgess Health Alliance, the non-profit parent company of Borgess Medical Center (Borgess). The agreements have various provisions, including the following:

- Health First, Inc. (HF) was formed with BCBSM and Borgess each as 50 percent shareholders. HF provides services to certain Company members who are located primarily in the metropolitan Kalamazoo area. HF reports negative equity of $4M at September 30, 2000. BCBSM traditionally eliminates 100 percent of the HF loss in consolidation and then reverses 50 percent of the loss (that should be recovered from Borgess) in reconciling to the financial statements. This was done at September 30, 2000. At December 31, 2000, BCBSM fully reserved the 50 percent that should be recovered from Borgess due to the ongoing negotiations regarding the disputed amounts.

- The Company capitates HF for gross premium revenue related to the Company members described above, less specified amounts for administrative and accounting services and reimbursement for reinsurance and other items. The Company reports premium payable to HF and claims receivable from HF in the due to and due from affiliates lines respectively on the financial statements.

Notes Receivable

The Company holds interest bearing 7 percent surplus certificate notes of BCI.

4. RETIREMENT INCOME PLANS

Substantially all employees of the Company who meet certain requirements of age and length of service are covered by the Company's defined benefit retirement income plans. Benefits paid to retirees are based on age at retirement, years of credited service and highest monthly average earnings over 60 consecutive months. The Company provides for and contributes to the plan as determined by BCBSM.

Effective January 1, 1999, the defined benefit retirement plans for non-represented employees was amended to a retirement account plan. Under the amended plan, each participant has an account balance in the plan to which interest credits and earnings credits are added. Interest will be credited quarterly based on the one year Treasury Bill rate. Earnings credits of 6 percent to 8 percent are credited to participants' account balances on a monthly basis. At retirement or termination, employees can elect to receive the lump sum value of their account balance or monthly payments.

The defined benefit plan for non-represented employees was amended effective January 1, 1998 to provide a 0.5 percent increase in benefits for managers and directors who were previously in the Pension Supplement Plan.

5. POSTRETIREMENT BENEFITS OTHER THAN PENSIONS

The Company provides certain health care and selected other benefits to all employees and their dependents. Represented and nonrepresented employees who have ten years of service after age 45 and retire from active employment, or who become disabled and meet certain benefit and service requirements are eligible.

This benefit is subject to revision at the discretion of the board of directors for nonrepresented employees and for represented employees, subject to collective bargaining agreements. These plans are noncontributory plans.

6. LEASES

The Company has entered into certain cancelable land and building leases with BCBSM. The Company also leased building space from BCBSM under a noncancelable operating lease and leases office buildings under operating leases with different unrelated parties.

Future minimum lease payments under all noncancelable operating leases as of September 30, 2000 are approximately $16,000,000.

7. CONTINGENCIES

The Company and its affiliated physicians are parties to lawsuits incidental to the operations of the HMO. Management believes the ultimate disposition of such contingencies will not have a material effect on the accompanying financial statements.

EXAMINATION FINDINGS AND RECOMMENDATIONS

1. Claims Payable

Our actuarial review of the claims payable liability as of September 30, 2000 has disclosed the liability to be deficient by $4,039,000. The Company's claims payable liability is developed from several components including a best estimate of claims unpaid, a credit for reinsurance recoverables, and several other accounting adjustments. The claims payable liability is further broken down into an amount for claims from claims lag triangles, an amount for claims unpaid classified as off-lag amounts, and a margin for adverse development. We tested several items to determine an estimate of reserve adequacy, including calculating a range of possible lag triangle estimates and selecting a best estimate with margin to compare to the Company's recorded amounts; estimating an amount for off-lag items; and verifying the reinsurance recoverable amounts. Based on our testing, we have found the Company's claims payable liability to be deficient by $4,039,000. We have increased claims payable and decreased net worth by $4,039,000 to reflect this adjustment. Our testing also disclosed a decrease of $3,868,000 to the reinsurance recoverable estimate, but this is completely offset by an equal increase within the stop-loss trust equity. Therefore, no adjustment to the reinsurance recoverable estimate is necessary.

We recommend the Company establish its claims payable liability using reasonable actuarial projections and strengthen its claims payable liability as necessary.

Note: Our review was performed both at September 30, 2000 and December 31, 2000. At December 31, 2000, our review of the Company's claims payable liability indicated a redundancy of $13,631,000.

2. Premiums Receivable

The Company failed to establish an adequate allowance account for premiums receivable. As a result, we have determined that premiums receivable is overstated by $4,562,977. Our sample testing revealed numerous retro-adjustments and cancellations to receivables established at our examination date. The Company does not routinely adjust the allowances in preparation of quarterly financial statements. The NAIC and good business practices require the establishment of accurate receivables for all filed financial statements. We are decreasing premiums receivable and net worth by $4,562,977 as a result. Our testing also disclosed the Company is charging a subscriber group rates that differ from rates filed with OFIS. Section 3525 of the Code requires the Company to charge rates as filed with OFIS.

We recommend the Company prepare quarterly financial statements including premiums receivable in accordance with NAIC requirements and charge only filed rates in compliance with Section 3525 of the Code. The Company has established a more appropriate allowance for doubtful accounts at December 31, 2000 and is charging the subscriber group referenced the filed rates in 2001.

3. <u>Financial Requirements</u>

The Company has negative working capital and negative cash flow from operations for 2000. Lack of positive working capital and cash flow from operations is a serious concern of the Company and OFIS. Section 3555 of the Michigan Insurance Code (Code) requires positive working capital and a means of achieving and maintaining a positive cash flow.

We recommend the Company submit a financial plan detailing efforts to comply with Section 3555 of the Code.

4. <u>Trust Indenture</u>

The trust indentures being used by the Company do not meet the requirements of the Code. Trust indentures are for the protection of members in the event of insolvency of the Company. The Company is using four separate indentures that existed prior to the merger of the four regions into one. Those indentures also do not utilize the current required format. Section 3553(4) of the Code requires the use of a trust indenture acceptable to the Commissioner.

We recommend the Company execute a current trust indenture in the format required by Section 3553(4) of the Code.

5. <u>Agreements</u>

Several agreements with affiliated companies need updating to comply with Chapter 13 of the Code. The MC-93 and MC-94 product agreements lack information on current rates being charged and the time frame required for reimbursement. The management services agreement with BCBSM needs updating for current fees being charged and the inclusion of payroll services provided by BCBSM. The agreement with Health First does not specify when amounts owed between the parties are to be settled. Current comprehensive agreements need to be submitted to OFIS in accordance with Chapter 13 in order to adequately evaluate the nature and extent of affiliated transactions.

We recommend the Company comply with Chapter 13 of the Code regarding the preparation and submission of affiliated agreements to OFIS.

CONCLUSION

As of our September 30, 2000 examination, we determined the Company to have assets of $395,756,579, liabilities of $321,042,992 and net worth of $74,713,587.

We appreciate the cooperation and assistance extended by the officers and employees of the Company.

In addition to the undersigned, Carrie L. Enos, Stephanie M. Gittens, Craig N. Rehse and Jessica L. Sterling, examiners of the Office of Financial and Insurance Services, and Martin Staehlin, FSA, MAAA, of PricewaterhouseCoopers, LLP, consulting actuaries participated in the examination.

Respectfully submitted,

Steven D. Honsowetz, CFE
Examiner-in-Charge
Office of Financial and Insurance Services

EXHIBIT I

STATEMENT OF ACTUARIAL OPINION

Quarterly Statement of Blue Care Network of Michigan For the Quarter Ending September 30, 2000

I, Martin E. Staehlin, Consulting Actuary, am associated with the firm of PricewaterhouseCoopers LLP (PwC), Certified Public Accountants, and am a member of the American Academy of Actuaries. I have been involved in the examination of accident and health claim reserves and certain other actuarial items of Blue Care Network of Michigan (the Company) for the quarter ended September 30, 2000.

I have examined the actuarial assumptions and actuarial methods used in determining the actuarial assets and liabilities indicated below, including claims payable, as adjusted as of September 30, 2000.

Contractual Settlements Receivable	(Report #1 - Part A: Assets Line 0702)	$7,669,330
Claims Payable	(Report #1 - Part B: Liabilities, Line 2	$176,358,852
Accrued Medical Incentive Pool	(Report #1 - Part B: Liabilities, Line 3)	$7,754,553
Physician Incentive – POS	(Report #1 - Part B: Liabilities, Line 0803)	$6,430,393
Accrued Claims Processing Liability	(Report #1- Part B: Liabilities, Line 0804)	$2,352;044
Postretirement Benefits Other Than Pensions	(Report #1- Part B: Liabilities, Line 1301)	$30,594,863
Accrued Pension	(Report #1 -Part B: Liabilities, Line 1302)	$7,589,994
Supplemental Pension Plan Liability	(Report #1 -Part B: Liabilities, Line 1303)	$109,218

In making my examination, I have relied upon relevant data prepared under the direction of Julie DeConinck, Vice President, Financial Analysis. I performed no verification as to the accuracy and completeness of this data. Additionally, I have not examined the Company assets. In other respects, my examination included such review of the actuarial assumptions and actuarial methods and such tests of the actuarial calculations as I considered necessary.

In my opinion, the reserves for unpaid claim liabilities and related actuarial items listed above:

- Are computed in accordance with commonly accepted actuarial standards consistently applied and are fairly stated in accordance with sound actuarial principles;
- Are based on actuarial assumptions which produce reserves at least as great as those called for in any policy or contract provision as to reserve basis and method and are in accordance with all other policy or contract provisions;
- Meet the requirements of the insurance laws of the State of Michigan;
- Make good and sufficient provision in the aggregate for all unmatured obligations of the Company guaranteed under the terms of its policies, based on actuarial assumptions as to future contingencies which I deem to be reasonable and appropriate under the circumstances;
- Are computed using methods and assumptions which are consistent with those used to prepare the estimates of these same actuarial items in the Annual Statement as of December 31, 1999; and
- Include provision for all actuarial reserves and related actuarial statement items, which ought to be established.

Actuarial methods, considerations, and analyses used in forming my opinion conform to the appropriate Standards of Practice as promulgated from time to time by the Actuarial Standards Board, which standards form the basis of this statement of opinion.

In addition to the items listed above, I have examined the actuarial assumptions and actuarial methods used in determining the premium deficiency reserves for the Company, recorded under Premium Deficiency Reserve as of September 30, 2000.

Premium Deficiency Reserve	(Report #1 -- Part B, Liabilities, Detailed Write-Ins)
$ 0	

In making my examination, I have relied upon relevant data and supporting analyses prepared under the direction of Patricia Turner, Vice President of Finance, augmented by analyses performed under my direction.

In my opinion, the premium deficiency reserves:

- Are computed in accordance with sound actuarial principles and use actuarial assumptions and methods that produce a best estimate of recoverable balances;

- Include provision for all potential impacts on the premium deficiency reserves using information known today.

The purpose of this review is to provide the state with an independent actuarial opinion and is provided every three years. The analysis of the premium deficiency reserve is, in substance, an actuarial valuation. This valuation was based upon generally accepted actuarial methods. We performed such tests as we considered necessary to ensure the accuracy of the results. We certify that the amounts presented in the referenced quarterly statement have been determined appropriately according to the actuarial assumptions and methods that we reviewed and tested. It should be recognized, however, that because future events frequently do not occur exactly as expected, there are usually differences between projected and actual results. Accordingly, there can be no assurance that actual experience will match our projections.

This opinion is updated in conjunction with the examination of the Company by the State of Michigan Office of Financial and Insurance Services. To the best of my knowledge, there have been no material changes from the quarterly statement documented in this opinion and the year-end financial statements immediately following this quarter.

Martin E. Staehlin, FSA, MAAA
August 14, 2001
(For a signed copy, please contact OFIS.)

c/o PricewaterhouseCoopers LLP (Corporate address)
203 North LaSalle Street
Chicago, IL 60601
(312) 701-5709 (Corporate phone number)

Exhibit 2 is the BCBSM family of companies organizational chart – please see the Commissioner Fitzgerald's presentation, slide 4.